United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

76-5028

In The

United States Court of Appeals

For The Second Circuit

In re:

UNISHOPS, INC.,

Debtor.

JEROME ZELIN,

Appellant,

vs.

UNISHOPS, INC.,

Appellee.

On Appeal from the United States District Court for the Southern District of New York.

BRIEF FOR APPELLEE

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Docket No. 76-5028

In re:

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-v-

UNISHOPS, INC.

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

APPELLEE'S BRIEF

Preliminary Statement

JEROME ZELIN (hereinafter "Zelin"), a stockholder and former officer and director of debtor UNISHOPS, INC. (hereinafter "Unishops"), appeals from the opinion and order (A38) dated August 2, 1976 of District Judge Thomas P. Griesa which reversed

the opinion (A20) and order (A35) of Bankruptcy Judge Roy Babitt. District Judge Griesa held that local Bankruptcy Rule XI-3 required that severance pay due officers, directors and/or stockholders of debtor corporations can only be entitled to priority treatment as an expense of administration if an order of the court has been entered fixing the severance pay as part of the claimant's compensation.

Question Presented

The sole issue on the appeal is whether the claim of an officer, director and stockholder of the debtor for severance pay constitutes a priority as an administration expense when the court's order fixing said claimant's compensation pursuant to local Bankruptcy Rule XI-3 does not make that severance pay part of the claimant's compensation.

Statement of Facts

The issues at bar were submitted to the trial court under an agreed stipulation of facts (A17). Unishops believes that only the following facts are relevant:

On November 30, 1973, Unishops filed a petition for an arrangement under Chapter XI, §322 of the Bankruptcy Act in the United States District Court for the Southern District of New York (A18). On the same date, an order was entered continuing Unishops in the operation and management of its business as a "debtor in possession" (A18). Prior to the filing of the petition, Zelin was Unishops' chief operating officer (A19), the owner of

35,900 shares of Unishops' common stock out of approximately 6 million shares outstanding (A17) and vice-chairman of Unishops's board of directors (A19).

At that time, Zelin had been employed by Unishops for eleven years (A17). On March 19, 1973, Unishops had executed a letter agreement (hereinafter the "Letter Agreement") (A10) with Zelin which is the basis of Zelin's claim. This two page document (A10) constitutes an agreement by Unishops to pay Zelin, on a monthly basis, $50,000.00 a year for a period of two years in the event that Zelin's employment with Unishops is terminated for any reason other than his death or voluntary resignation. This "severance pay" provision was "in consideration of [Zelin's] agreeing to continue at the time as chief operating officer..." The Letter Agreement is as important for what it does not say as it is for what it does say. Since there is no mention of salary, vacation, sick leave, pension or retirement benefits, medical insurance, etc., it is clear that the agreement does not spell out the full terms of Zelin's employment by Unishops. The Letter Agreement is limited solely and exclusively to an obligation on the part of Unishops to pay certain sums of money upon the termination of Zelin's employment. This Agreement is the only writing between Unishops and Zelin relating to Zelin's employment with Unishops (A17).

On December 6, 1973 an application was made to Judge Babitt for approval of officers' compensation pursuant to local

Bankruptcy Rule XI-3 applicable in the Southern District of New York (A18). Among the materials submitted on the application was a description of Zelin as Vice Chairman of the Board of Directors and Chief Operating Officer, and the duties performed by him. Approval was requested for payment of Zelin's salary in the amount of $100,000 per year. No request was made to the court for approval of any severance pay (A40). On December 7, 1973 Bankruptcy Judge Babitt entered an order approving officers' salaries, including the $100,000 per year for Zelin. This was Zelin's salary prior to the filing of the Chapter XI petition (A18). There was no reference in the order of December 7, 1973 to severance pay (A40). No adoption or approval of the Letter Agreement was sought at that time or any time thereafter. On or about July 16, 1974, during the course of the arrangement proceedings, Unishops discharged Zelin (A19). On December 3, 1974, an order was entered terminating the Letter Agreement effective July 16, 1974 (A19).

Thereafter, Zelin filed a "priority" claim in this proceeding (docket #2246) (A8) for the $100,000.00 payable under the Letter Agreement, as an expense of administration of the debtor in possession entitled to priority under §64a(1) of the Bankruptcy Act, 11 U.S.C. §104(a)(1). Unishops objected to the allowance of the claim as a priority claim (A12), claiming Zelin's claim was entitled only to the status of a general unsecured claim. Following submission of the issue, Bankruptcy Judge Babitt ruled in his August 26, 1975 opinion (A20) that the claim was entitled to priority treatment as an administration expense of the debtor in possession. An

order to that effect was entered (A35). Unishops appealed to the District Court and Bankruptcy Judge Babitt's opinion and order were reversed by District Judge Griesa (A38). Zelin appeals (A46) from District Judge Griesa's opinion and order (A38) declaring his claim (docket #2246) to be a general claim.

Summary of Appellee's Case

Unishops' position, adopted by the district court, is outlined as follows:

1) Local Bankruptcy Rule XI-3 prohibits the payment of "compensation" by a debtor corporation to insiders such as officers, stockholders and directors, subsequent to commencement of a Chapter XI arrangement proceeding, without a prior order of the court approving the employment and fixing such "compensation".

2) The term "compensation" as used in local Bankruptcy Rule XI-3 includes "severance pay" such as Unishops was obligated to pay Zelin under the Letter Agreement.

3) The order entered on December 7, 1973 regarding Zelin (an officer, stockholder and director of the debtor corporation) pursuant to local Bankruptcy Rule XI-3 did not fix the severance pay as part of Zelin's compensation.

4) The absence of judicial scrutiny and approval regarding the severance pay provision of Zelin's employment by the debtor as required by local Bankruptcy Rule XI-3 prevents Zelin's severance pay claim from achieving priority status as an expense of administration of the debtor in possession.

POINT I

THE LETTER AGREEMENT OF MARCH 19, 1973 DEALT WITH "COMPENSATION" AND FAILED TO BECOME AN OBLIGATION OF THE DEBTOR IN POSSESSION DUE TO NON-COMPLIANCE WITH LOCAL BANKRUPTCY RULE XI-3.

Local Bankruptcy Rule XI-3, adopted by the Judges of the United States District Court for the Southern District of New York provides as follows:

> "Rule XI-3 -- Compensation to Debtor.
>
> "No compensation shall be paid to the debtor, if an individual, or to the members of a copartnership, if a copartnership, or to an officer, stockholder or director of a corporation, if a corporation, from the time of the filing of the petition until confirmation of the arrangement unless a prior order of the court shall have been obtained approving the employment and fixing the compensation."

Inasmuch as Zelin was an officer, stockholder and director of Unishops on November 30, 1973 when Unishops' arrangement petition was filed, his employment by the debtor in possession had to be approved by "a prior order of the court" and his "compensation" would likewise have to be fixed by court order. Local Bankruptcy Rule XI-3 was of course complied with and on December 7, 1973 Bankruptcy Judge Babitt signed an order approving Zelin's employment as Vice-Chairman of Unishops and fixing his salary at $100,000 per annum. "Salary" was the only item of "compensation" covered by the order of December 7, 1973 and no other orders were entered pursuant

to local Bankruptcy Rule XI-3 affecting Zelin's compensation.

It is the position of Unishops, adopted by District Judge Griesa, that local Bankruptcy Rule XI-3 "...refers to officer compensation in general, and clearly covers severance pay..." (A44) Judge Griesa's conclusion is self-evident. However, Bankruptcy Judge Babitt erroneously concluded "...that severance pay is not compensation for employment but for the termination of employment; severance pay is not wages, but damages..." (A31). Obviously, the pivotal question is whether "severance pay" is "compensation" within the meaning of local Bankruptcy Rule XI-3.

According to Black's Law Dictionary (4th ed. 1951), at 354, "compensation" means:

> "The remuneration or wages given to an employee or, especially, to an officer. Salary, pay, or emolument. Christopherson v. Reeves, 44 S.D. 634, 184, N.W. 1015, 1019; Higgins v. Glenn, 65 Utah, 406, 237 P. 513, 515.
>
> "The ordinary meaning of the term 'compensation,' as applied to officers is remuneration, in whatever form it may be given,...State v. Bland, 91 Kan. 160, 136 P. 947, 949...."

It is obvious that Unishops' contractual commitment to pay money to Zelin upon the happening of a future event, i.e., Unishops' termination of Zelin's employment, is a form of remuneration for Zelin's continued performance as Unishops' Vice-chairman and Chief Operating Officer. Indeed the Letter Agreement recites that the consideration for Unishops' promise to pay is Zelin's continued employment (A10).

Zelin seeks to draw a distinction between "compensation" and "severance pay". His position is that the word "compensation" as used in local Bankruptcy Rule XI-3 means "...salaries paid for services rendered..." and nothing more. [See Appellant's Brief, at 20.]*

But "compensation" and "salary" are not co-extensive terms and had the rule makers intended to limit Rule XI-3 to "salary" they would have said so. People ex rel. Bockes v. Wemple, 115 N.Y. 302, 209, 211, 22 N.E. 273 (1889) rev'g 52 Hun. 414, S N.Y.S. 495 (Sup. Ct. 3rd Dept. 1889). In the Wemple case, supra, the Court of Appeals ruled that while a $1,200 payment to a Supreme Court Justice in lieu of expenses was not salary, it was compensation. The court was construing the word "compensation" found in the state constitution and a statute.

A fair reading of the federal bankruptcy cases dealing with "severance pay" also indicates that it constitutes "compensation." In Straus-Duparquet, Inc. v. Local Union No. 3, 386 F.2d 649, 651 (2d Cir. 1967) the court held that:

> "[s]everance pay is
> 'a form of compensation for the termination
> of the employment relation,...' "

A number of courts have held severance pay to be "wages": McCloskey v. Division of Labor Law Enforcement, 200 F.2d 402 (9th Cir. 1952); In re Public Ledger, Inc., 161 F.2d 762, 772-73 (3d Cir. 1947); In re S.E.S. Meat Co., CCH Bankr. L. Rep, ¶64,668, (S.D.N.Y. 1972) (decision of Babitt, B.J.). Black's Law Dictionary, supra, at p. 1750, defines "wages" as:

...

*Herinafter, "Appt. Br. at ".

> "A compensation given to a hired person for his or her services; the compensation agreed upon by a master to be paid to a servant, or any other person hired to do work or business for him. Ciarla v. Solvay Process Co., 172 N.Y.S. 426, 428, 184 App. Div. 629; Cookes v. Lymperis, 178 Mich. 299, 144 N.W. 514, 515; Phoenix Iron Co. v. Roanoke Bridge Co., 169 N.C. 512, 86 S.E. 184, 185. Every form of remuneration payable for a given period to an individual for personal services, including salaries, commissions, vacation pay, dismissal wages, bonuses and reasonable value of board, rent, housing, lodging, payments in kind, tips, and any other similar advantage received from the individual's employer or directly with respect to work for him. Ernst v. Industrial Commission, 246 Wis. 205, 16 N.W. 2d 867."

The term "wages" does appear to be co-extensive with "compensation".

The rule in New York State is that severance pay constitutes compensation earned. Montefalcone v. Banco Di Napoli Trust Co. of New York., 268 App.Div.636, 52 N.Y.S.2d 655, 658 (1st Dept. 1945). As noted in that case:

> "But the cause of action here...[rests]... upon the theory...that upon the severance of the relationship, from whatever cause other than dereliction of duty, he became entitled to the benefit of the additional compensation established for his benefit. Such "severance pay" was not in any true sense damages, but constituted compensation earned, the amount of which was measured by the extent of previous service. People ex rel. Metropolitan Life Ins. Co. v. Hotchkiss, 136 App.Div. 150, 120 N.Y.S. 649; Scott v. P. Lorillard Co. 108 N.J. Eq. 153, 154 A. 515."

Thus "compensation" refers to all forms of remuneration. The term clearly encompasses salary, bonuses, stock options and severance pay.

Unishops' contractual obligation under the Letter Agreement to pay severance pay to Zelin constituted compensation earned by Zelin for his employment by Unishops both prior and subsequent to execution of the Letter Agreement.

Zelin would, in effect, have this court rewrite local Bankruptcy Rule XI-3 to read "No salary shall be paid..." rather than "No compensation shall be paid..." Yet it is well established that whether reading a constitution, statute or rule, words are to be taken in their natural, plain, obvious and ordinary meaning; and that only where a literal acceptance of the words as written will work a mischief or an absurd result will a court search elsewhere for the meaning. People ex rel Bockes v. Wemple, supra, 115 N.Y. at 307-308 and cases cited therein.

But Zelin, ignoring all rules of judicial construction, draws his own conclusions as to the meaning of "compensation" in Rule XI-3:

> "The background of the Rule requires no detailed analysis. It was intended to govern the "compensation" paid to officers of a debtor-in-possession for services rendered during the proceeding. If the Court felt that the salary paid to the officer prefiling was excessive, it could be reduced. The word "compensation", however, has been understood to mean precisely what it says, namely salaries paid for services rendered." Appt.Br., at 20.

To limit the term "compensation" to "salaries" as suggested by Zelin is in conflict with the obvious intent of local Bankruptcy Rule XI-3. There are many ways an insider can be com-

pensated other than by salary and all compensation to insiders in the context of court supervised arrangement proceedings should receive judicial scrutiny as envisaged by the rule.

In summary, this court should and must apply local Bankruptcy Rule XI-3 to the Zelin claim, giving that rule its clear and obvious meaning. "Severance pay" is "compensation" as that term is used in Rule XI-3. District Judge Griesa's ruling must be affirmed.

POINT II

ASSUMING ARGUENDO THAT RULE XI-3 IS INAPPLICABLE, A DEBTOR IN POSSESSION CANNOT ASSUME A CONTRACT LIKE THE "LETTER AGREEMENT" WITHOUT EXPRESS COURT APPROVAL.

The rule in this Circuit is that a receiver, trustee or debtor in possession may only incur ordinary expenses and liabilities without previous sanction of the court. As stated in In re Wil-low Cafeterias, Inc., 111 F.2d 429, 431 (2d Cir. 1940):

> "In Chicago Deposit Vault Co. v. McNulta, 153 U.S. 554, at page 561, 14 S. Ct. 915, at page 918, 38 L.Ed.819, the Supreme Court remarked: 'It is undoubtedly true that a receiver, without the previous sanction of the court, manifested by special orders, may incur ordinary expenses or liabilities for supplies, material, or labor needed in the daily administration of railroad property committed to his care as an officer of the court; but it seems equally well settled that the courts decline to sanction the exercise of this discretion on the part of receivers in respect to large outlays, or contracts extending beyond the receivership, and intended to be binding upon the trust." The same general rule was laid down in Northern Pac. Ry. Co. v. American Trading Co., 195 U.S. 439, 461, 25 S.Ct.84, 49 L.Ed. 269."

At issue in the Wil-low Cafeterias case, supra, was the power of a debtor in possession in a §77B reorganization proceeding to enter into a collective bargaining agreement without the sanction of a court order. The proceeding was commenced on April 20, 1937 and the agreement entered into on May 11, 1938. The reorganization aborted, and a discharged employee sought priority for his claim of one week's vacation pay under the contract as an administrative expense of the debtor in possession. Noting that an order had been entered authorizing the debtor to operate the business, the court concluded that the debtor in possession was authorized by that order"... to make the simple and usual contracts of hiring necessary to the authorized conduct of the business..." Id., at 431.

In reaching this conclusion, the court relied on its prior decision in In re Avorn Dress Co., Inc., 78 F.2d 681 (2d Cir. 1935). In that case, Circuit Judge Swan held that a debtor continued in possession by court order could contract to buy goods on credit without special court authorization, but could not pledge accounts receivable without a court order. Judge Swan noted:

> "...No doubt any unusual contract would require express authorization, but normal purchases and sales would be permissible without a special order. [citations omitted] ..." Id., at 683.

See to the same effect, In re Avorn Dress Co., Inc., 79 F.2d 337 (2d Cir. 1935).

There is no valid justification for treating pre-proceeding agreements differently from those entered into during the proceeding if the ultimate question is whether claims

arising under such an agreement are entitled to priority treatment as administration claims. The only distinction is that the pre-proceeding agreement must be assumed by the debtor in possession. American Anthracite & Bituminous Coal Corp. v. Leonard Arrivabene, S.A., 280 F.2d 119, 124 (2d Cir. 1960).* This is contrasted with the mere execution of the agreement in the context of the proceeding. This is a distinction without a difference. A court order is always required, although, as noted in the Avorn Dress and Wil-low Cafeterias cases, supra, the order of continuance [see §§342 and 343 of the Bankruptcy Act, 11 U.S.C. §§742 and 743] will be sufficient to support "simple and ordinary contracts" such as collective bargaining agreements. In re Wil-low Cafeterias, Inc., supra; Straus-Duparquet, Inc. v. Local Union No. 3, supra.

Returning to the particulars of our case, the following items should be noted:

> (1) The Letter Agreement involved the compensation (i.e. severance pay) of the chief operating officer of the debtor who was a substantial stockholder [35,900 shares] and vice-chairman of the board of directors (A17, A19);
>
> (2) The Letter Agreement required approval by Unishops' Board of Directors (A11); and
>
> (3) The Letter Agreement involved the sum of $100,000.00.

These items must take the Letter Agreement out of the category of

...

*As noted therein: "...The claim of a creditor having an executory contract with the debtor at the time the debtor's petition is filed is entitled to priority under these provisions [§64a(1) of the Bankruptcy Act, 11 U.S.C. §104(a)(1)]only if the trustee or debtor in possession elects to assume the contract or if he receives benefits under it...."Id., at 124.

"simple and ordinary." The Letter Agreement is not a contract encompassed within the terms of the order of continuance. It deals with an insider and could only be assumed by express order of the court.

POINT III

UNISHOPS' FAILURE TO REJECT THE LETTER AGREEMENT PER §313(1) DOES NOT CONSTITUTE AN ASSUMPTION OF THE AGREEMENT BY THE DEBTOR IN POSSESSION.

It is argued by Zelin that in an arrangement proceeding, any contract made by the debtor is assumed by and becomes an obligation of the debtor in possession unless expressly rejected under the provisions of either §§313(1) or 357(2) of the Bankruptcy Act, 11 U.S.C. §§713(1) or 757(2). Appt. Br. at 8-12, 14-15. This conclusion is not in accord with the rationale of the Wil-low Cafeterias and Avorn Dress cases, supra. [See Point II, supra.] Furthermore, local Bankruptcy Rule XI-3 creates a specific, explicit exception to this purported principle of law which governs the facts at bar. [See Point I, supra.]

However, as Zelin's appeal relies completely on the principle of assumption by non-rejection, that alleged principle requires close scrutiny. First, the principle, if it is in fact a proper statement of the law, would apply only to those "executory contracts" encompassed by §313(1) of the Bankruptcy Act, 11 U.S.C. §713(1). In other words, a contract which cannot be rejected by a debtor, cannot be deemed assumed due to a failure to reject. In re

Grayson-Robinson Stores, Inc., 321 F.2d 500 (2d Cir. 1963). Appellee Unishops believes that the Letter Agreement was not such an "executory contract" as could be rejected.

Second, the asserted principle must be examined as to its general validity and specific application to the facts at bar. It is Unishops' position that the principle is not valid.

A. The Letter Agreement Was Not "Executory".

What is an executory contract? A leading commentator has answered that question as follows:

> "As Professor Williston has said, 'All contracts to a greater or less extent are executory. When they cease to be so, they cease to be contracts.' But that expansive meaning can hardly be given to the term as used in the Bankruptcy Act or even to the Act's occasional alternative reference to contracts 'executory in whole or in part.' The concept of the 'executory contract' in bankruptcy should be defined in the light of the purpose for which the trustee is given the option to assume or reject. Similar to his general power to abandon or accept other property, this is an option to be exercised when it will benefit the estate. A fortiori, it should not extend to situations where the only effect of its exercise would be to prejudice other creditors of the estate." Countryman, Executory Contracts In Bankruptcy, Part I, 57 MINN.L.R. 439, 450-51 (1973).

This Court, when faced with the question of whether a guaranty was an "executory" contract, responded:

> "The unsatisfactory character of the 'naked' question of law which has been certified is illustrated by the difficulty presented by the term 'executory contracts.' Williston notes that all contracts are executory ' to a

> greater or less extent.' 1 Williston, Contracts §14, at 28 (3d ed. 1957). In a sense, then, the question certified is meaningless apart from concretization based on the specific facts of the particular situation. In order to determine with confidence whether any particular contract is to be considered executory within the meaning of Section 313(1), we must know why the question is asked and what would be the consequences of the answer 'yes' or the answer 'no'." In re Grayson-Robinson Stores, Inc., supra, at 502.

Thus the question must be asked and answered: What would be the intent of Unishops in seeking to reject the Letter Agreement?

Assuming that Unishops wished to be relieved of the obligation to pay severance pay to Zelin upon the termination of his employment, could this result be achieved by rejection of the Letter Agreement? The answer is "No". The Letter Agreement is not an employment contract per se, because it is limited to an obligation by Unishops to pay money to Zelin upon the termination of Zelin's employment. It does not encompass any of the other normal items covered by an employment agreement such as term, salary, vacation, sick leave, etc. The only performance required of Unishops was payment. This situation is essentially the same as where a seller of goods has delivered the goods before bankruptcy and argues that since the trustee in bankruptcy had not assumed the contract of sale, the contract must be deemed "rejected" under §70b of the Bankruptcy Act, 11 U.S.C. §110(b). As stated in Stell Manufacturing Co. v. Gilbert, 372 F.2d 113, 115 (5th Cir. 1967):

> "As already seen, the only thing that remained executory about this contract [for the sale of custom-build furniture] was the obligation to pay. Therefore, §70(b) does not apply, In Re Forney, 7 Cir., 1962, 299 F.2d 502...."

See also, In re San Francisco Bay Exposition, 50 F. Supp 344, 345-47 (N.D. Cal. 1943).

Applying this holding to Chapter XI proceeding such as the case at bar, the proposition should be phrased that there is no purpose in seeking rejection of a contract where the debtor's only obligation is to pay. After all, "...rejection of an executory contract...[under the Bankruptcy Act]...constitute[s] a breach of such contract..." §63c of the Bankruptcy Act, 11 U.S.C. §103(c). Similarly, a debtor's refusal to make payments due under an executory contract is likewise a breach of that contract. Rejection is meaningless in this situation because a debtor cannot repudiate its obligations. In re Grayson-Robinson Stores, Inc., supra, at 502.

To restate the obvious, while every contract is executory or it would not be a contract, every contract is not an "executory contract" as that term is used in the Bankruptcy Act. There are certain contracts that cannot be rejected in an arrangement proceeding because rejection is meaningless. In this category are all contracts where the other party has fully performed and the debtor's only obligation is to pay money. Professor Countryman's commentary is again instructive:

> "Executory contracts, in the sense in which Professor Williston spoke, abound in a bankruptcy proceeding. One example is the contract under which the nonbankrupt party has fully rendered the performance to which the bankrupt is entitled, but which the bankrupt has performed only partially or not at all. Such a contract will give the nonbankrupt party a provable claim in the bankruptcy proceeding, whether it is liquidated or unliquidated and whether it is absolute or contingent as to liability. The trustee's option to assume or reject should not extend to such contracts. The estate has whatever benefit it can obtain from the other party's performance and the trustee's rejection would neither add to nor detract from the creditor's claim or the estate's liability. His assumption, on the other hand, would in no way benefit the estate and would only have the effect of converting the claim into a first priority expense of administration and thus of preferring it over all claims not assumed- a prerogative which the Bankruptcy Act has never been supposed to have vested in either the trustee or the court." Countryman, Op. cit., at 451-52 (Emphasis supplied.)

The question raised by Countryman is one of "benefit to the estate". This proposition is derived from this court's decision in the American Anthracite case, supra. There is no benefit to the estate in assuming the Letter Agreement, particularly since Zelin's employment was not linked to the Letter Agreement. Had Zelin insisted upon an assumption of the Letter Agreement as he was entitled to do (In re Greenpoint Metallic Bed Co., Inc., 113 F2d 881 (2d Cir. 1940)) the benefit question would have been properly raised, giving Unishops, the creditors and the court an opportunity to balance the benefit of Zelin's continued employment against a $100,000 administration liability. But conjecture into this area is unprofitable, because Zelin never linked his employment by the

debtor in possession to assumption of the Letter Agreement.

Assumption of the Letter Agreement by the debtor in possession does not make common sense. It is Zelin's obligation to show that there was such an assumption. But Zelin can point to no affirmative act by the debtor in possession to assume this obligation, and can therefore only rely upon a precarious inference drawn from Unishops' failure to "reject" the Letter Agreement.* However, since the Letter Agreement could not have been rejected, no inference of assumption can be drawn from the failure to reject.

B. Assumption Requires Court Sanction.

Zelin's position that all debtor contracts not expressly rejected in an arrangement proceeding are deemed assumed by the debtor in possession, stands on a questionable foundation. The authority relied upon by Zelin can easily be distinguished. The authority consists of two cases and a commentary. These three supposed authorities are all interrelated and must stand or fall together.

Starting with 8 Collier on Bankruptcy ¶3.15[6], relied upon by Bankruptcy Judge Babitt (A28) and Zelin [Appt. Br. at 10-11.], we find the key statement, i.e., that unless a contract is rejected by affirmative action under §313(1) and Chapter XI Rule 11-52 or §357(2), the contract continues in effect, is supported by footnote 24. This footnote refers to Smith v. Hill, 317 F2d 539 (9th Cir. 1963) which quotes from an earlier edition of Collier and also refers to Consolidated Gas Electric Light & Power Co. of Baltimore v. United Railways & Electric Co. of Baltimore,

...

*An order was entered on December 3, 1974 terminating the Letter Agreement (A19).

85 F.2d 799, 805 (4th Cir. 1936), cert. den. 300 U.S. 663 (1937).

Smith v. Hill, supra, was not even concerned with the issue of assumption or rejection, though a footnote contains obiter dicta quoting Collier. Id., at 542, n.6. The Consolidated Gas case, supra, must therefore be viewed as the foundation of Zelin's argument. There the court merely stated:

> "...An executory contract...remains in force in a proceeding under Section 77B until it is rejected, and unless rejected, it passes with other property of the debtor to the reorganized corporation." Id., at 805.

Understandably, the court in Consolidated Gas, supra, did not limit rejection to affirmative action under §§313(1) or 357(2) of the Bankruptcy Act, 11 U.S.C. §§713(1) or 757(2), or their antecedents under §77B, as does Collier. It could therefore be concluded that a contract can be rejected or breached other than as stated by Collier. Ths would bring Consolidated Gas, supra, in line with this Court's ruling in In re Greenpoint Metallic Bed Co., Inc., supra. As noted in United Properties, Inc. v. Emporium Department Stores, Inc., 379 F.2d 55, 62 (8th Cir. 1967):

> "Greenpoint is authority for the proposition that an executory contract must be expressly affirmed, and that in the absence of such affirmation, it is rejected. It also indicates that the holder of such a contract should assert his rights at the confirmation hearing before the Referee, and appeal from the confirmation order if dissatisfied; and that failing to do so, absent the special circumstances found in Greenpoint, cannot assert his rights in a subsequent motion."

In the Greenpoint case, supra, the debtor filed under Chapter XI on December 13, 1939. On January 2, 1940, the debtor notified the claimant Ratner that the contract was terminated. On January 4, Ratner notified the debtor that it would hold the debtor accountable for damages. The debtor in possession thereafter did two things which indicated a rejection of the employee's contract: (1) it refused to allow the employee to work while the case was pending, and (2) notified the employee prior to confirmation that the contract was terminated because of an alleged but nonexistent breach by the employee. The court, although it refused to recognize the employee as a creditor with a claim, nevertheless allowed the employee to prove damages as if a contract had been rejected and to receive 20% payment thereof.

At bar, Zelin argues that the debtor in possession assumed the Letter Agreement by failing formally to reject it. But as in Greenpoint, supra, the mere failure formally to reject the Letter Agreement does not signify an assumption. The Letter Agreement was in fact terminated by a court order dated December 3, 1974. This mode of termination should be even more favored than the method used in Greenpoint, supra.

A further comment is necessary regarding the character of the Letter Agreement. As it was not an employment agreement, but merely a contract concerned solely with severance pay, Unishops had no performance obligations until the time of Zelin's discharge. Thus Unishops as debtor in possession never performed

under the Letter Agreement, but repudiated its obligation to perform from the first moment that pferformance was due. "Moreover, for a trustee 'to knowingly conform to the terms of a contract ... is quite different from its assumption'." In Re Luscombe Engineering Co., 268 F.2d 683, 686 (3d Cir. 1959). All told, the record is bare of any evidence indicating an assumption of the Letter Agreement by the debtor in possession.

C. Straus-Duparquet Distinguished.

There are a number of material differences between the case at bar and the situation before the court in the Straus-Duparquet case, supra. First, Straus-Duparquet dealt with a collective bargaining agreement which included severance pay provisions, while at bar there is only a severance pay agreement. Second, Straus-Duparquet dealt with employees, while Zelin was an insider subject to special considerations, including the provisions of local Bankruptcy Rule XI-3. Third, in Straus-Duparquet the debtor in possession performed under the collective bargaining agreement, while at bar, Unishops never performed under the Letter Agreement. Fourth, the decision in Straus-Duparquet does not speak to the issue of assumption of the collective bargaining agreement or termination thereof, thus creating the impression that the agreement was assumed, while Zelin's Letter Agreement was terminated by court order. See also, In re Mammoth Mart, Inc., 536 F.2d 950 (1st Cir. 1976).

D. Summary.

The purpose of the foregoing argument was to refute

any implication that Unishops, as debtor in possession, assumed the Letter Agreement by failing to reject it. The issue is "assumption", not "failure to reject." Zelin argues that the failure formally to reject the Letter Agreement by court order or as part of the arrangement constitutes an "assumption" of the Letter Agreement by the debtor in possession. Unishops argues that the nature of the Letter Agreement prevented it from being capable of rejection and the December 3, 1974 order terminating the Letter Agreement made formal rejection meaningless. Since rejection was neither possible nor meaningful, the failure to reject is not evidence of "assumption". In essence, without assumption of the Letter Agreement by the debtor in possession, Zelin's claim is a general unsecured claim and District Judge Griesa's order must be affirmed.

CONCLUSION

Local Bankruptcy Rule XI-3 required the court to fix all compensation to be paid by a debtor in possession to an insider such as Zelin by prior court order. Even absent the local rule, court sanction would be necessary for the debtor in possession to assume the debtor's severance pay obligation to Zelin. There was no such court authorization. The Letter Agreement was ter-

minated by court order and Zelin's claim is not an expense of administration, but a general unsecured claim. District Judge Griesa's decision and order so holding must be affirmed.

Respecfully submitted,

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A 202 Affidavit of Personal Service of Papers

LUTZ APPELLATE PRINTERS, INC.

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

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143 ESTATES, INC.,

Appellant,

- against -

UNISHOPS, INC., MIDDLETOWN CENTER, INC.,

Appellees.

Index No.

Affidavit of Personal Service

STATE OF NEW YORK, COUNTY OF NEW YORK *ss.:*

I, Victor Ortega, *being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age and resides at* 1027 Avenue St. John, Bronx, New York
That on the 29th *day of* November *1976 at* 655 Third Ave. New York, N.Y.

deponent served the annexed brief

Nathanson, Reich & Barrison *upon*

the attorneys *in this action by delivering a true copy thereof to said individual personally. Deponent knew the person so served to be the person mentioned and described in said papers as the* Attorney(s) *herein.*

Sworn to before me, this 29th
day of November *19* 76

Beth A. Hirsh
BETH A. HIRSH
NOTARY PUBLIC, State of New York
No. 41-4623156
Qualified in Queens County
Commission Expires March 30, 1978

Victor Ortega
VICTOR ORTEGA